Comparison of Major Contract Types

	Firm-Fixed-Price (FFP)	Fixed-Price Economic Price Adjustment (FPEPA)	Fixed-Price Incentive Firm Target (FPIF)	Fixed-Price Award-Fee (FPAF)	Fixed-Price Prospective Price Redetermination (FP³R)	Cost-Plus-Incentive-Fee (CPIF)	Cost-Plus-Award-Fee (CPAF)	Cost-Plus-Fixed-Fee (CPFF)	Cost or Cost-Sharing (C or CS)	Time & Materials (T&M)
Principal Risk to be Mitigated	None. Thus, the contractor assumes all cost risk.	Unstable market prices for labor or material over the life of the contract.	Moderately uncertain contract labor or material requirements.	Risk that the user will not be fully satisfied because of judgmental acceptance criteria.	Costs of performance after the first year because they cannot be estimated with confidence.	Highly uncertain and speculative labor hours, labor mix, and/or material requirements (and other things) necessary to perform the contract. The Government assumes the risks inherent in the contract, benefiting if the actual cost is lower than the expected cost, or losing if the work cannot be completed within the expected cost of performance.				
Use When . . .	The requirement is well-defined. •Contractors are experienced in meeting it. •Market conditions are stable. •Financial risks are otherwise insignificant.	The market prices at risk are severable and significant. The risk stems from industry-wide contingencies beyond the contractor's control. The dollars at risk outweigh the administrative burdens of an FPEPA.	A ceiling price can be established that covers the most probable risks inherent in the nature of the work. The proposed profit sharing formula would motivate the contractor to control costs and to meet other objectives.	Judgmental standards can be fairly applied by the fee determining official. The potential fee is large enough to both: •Provide a meaningful incentive. [1] •Justify related administrative burdens.	The Government needs a firm commitment from the contractor to deliver the supplies or services during subsequent years. The dollars at risk outweigh the administrative burdens of an FPRP.	An objective relationship can be established between the fee and such measures of performance as actual costs, delivery dates, performance benchmarks, and the like.	Objective incentive targets are not feasible for critical aspects of performance. Judgmental standards can be fairly applied. Potential fee would provide a meaningful incentive.	Relating fee to performance (e.g., to actual costs) would be unworkable or of marginal utility.	The contractor expects substantial compensating benefits for absorbing part of the costs and/or foregoing fee or the vendor is a non-profit entity.	No other type of contract is suitable (e.g., because costs are too low to justify an audit of the contractor's indirect expenses).
Elements	A firm-fixed-price for each line item or one or more groupings of line items.	•A fixed-price, ceiling on upward adjustment, and a formula for adjusting the price up or down based on: •Established prices. •Actual labor or material costs. •Labor or material indices.	•Ceiling price •Target cost •Target profit •Delivery, quality, or other performance targets (optional) •Profit sharing formula •120 % ceiling and 50/50 share are points of departure	•Fixed-price. •Award amount •Award fee evaluation criteria and procedures for measuring performance against the criteria	•Fixed-price for the first period. •Proposed subsequent periods (at least 12 months apart). •Timetable for pricing the next period(s).	•Target cost •A minimum, maximum, and target fee •A formula for adjusting fee based on actual costs and/or performance •Performance targets (optional)	•Estimated cost •Base amount, if applicable, and an award amount •Award fee evaluation criteria and procedures for measuring performance against the criteria	•Estimated cost •Fixed fee	•Total estimated cost •No fee •If CS, an agreement on the Government's share of the cost.	•Ceiling price •A per-hour labor rate that also covers overhead and profit •Provisions for reimbursing direct material costs
Contractor is Obliged to:	Provide an acceptable deliverable at the time, place and price specified in the contract.	Provide an acceptable deliverable at the time and place specified in the contract at the adjusted price.	Provide an acceptable deliverable at the time and place specified in the contract at or below the ceiling price.	Perform at the time, place, and the price fixed in the contract.	Provide acceptable deliverables at the time and place specified in the contract at the price established for each period.	Make a good faith effort to meet the Government's needs within the estimated cost in the Contract, Part I the Schedule, Section B Supplies or services and prices/costs.				Make a good faith effort to meet the Government's needs within the ceiling price.
Contractor Incentive *(other than maximizing goodwill)* [1]	Generally realizes an additional dollar of profit for every dollar that costs are reduced.	Generally realizes an additional dollar of profit for every dollar that costs are reduced.	Realizes profit on cost by completing work below the ceiling price. May earn higher profit by incurring costs below the target cost or by meeting objective performance targets.	Generally realizes an additional dollar of profit for every dollar that costs are reduced; earns an additional fee for satisfying the performance standards.	For the period of performance, realizes an additional dollar of profit for every dollar that costs are reduced.	Realizes a higher fee by completing the work at a lower cost and/or by meeting other objective performance targets.	Realizes a higher fee by meeting judgmental performance standards.	Realizes a higher rate of return (i.e., fee divided by total cost) as total cost decreases.	If CS, shares in the cost of providing a deliverable of mutual benefit.	
Typical Application	Commercial supplies and services.	Long-term contracts for commercial	Production of a major system based on a	Performance-based contracts.	Long-term production of spare parts for a	Research and development of the prototype for	Large scale research study.	Research study.	Joint research with educational institutions.	Emergency repairs to heating plants and aircraft engines

[1] Goodwill is the value of the name, reputation, location, and intangible assets of the firm.

CONTRACT CATEGORY CHARACTERISTICS

	COST-REIMBURSEMENT	FIXED-PRICE
PROMISE	Best Efforts	Shall Deliver
RISK TO CONTRACTORS	Low	High
RISK TO GOVERNMENT	High	Low
CASH FLOW	As Incurred	On Delivery
PROGRESS PAYMENTS	None	% of Actual
ADMINISTRATION	Max Government	Min Government
FEE/PROFIT	Fee	Profit

"QUALITY MANAGEMENT"

DAG 11.3.3.2 Incentivizing Higher Quality in Contracts

Contract incentives can be structured to ensure quality by contributing to the contractor's value proposition. Factors that are typically important aspects of a contractor's value proposition include:

- Customer satisfaction;
- Planning stability;
- Good financial performance; and
- Improved cash flow.

Listed below are examples of contract incentives that can be made available to the prime contractor and the prime contractor can in turn make available to subcontractors under the appropriate conditions:

- Increased fee;
- Extended contract length;
- Follow-on contracts awarded;
- Accelerated progress payments;
- Shared savings; and
- Opportunities for return on investments (some of which may increase the contractor's competitiveness on other contracts).

The DAG does not reflect the changes in the DoDI5000.02. Work is in progress to update the content and will be completed as soon as possible.

NEGOTIATING CONTRACT TYPE

FAR 16.103

(a) Selecting the contract type is generally a matter for negotiation and requires the exercise of sound judgment. Negotiating the contract type and negotiating prices are closely related and should be considered together. The objective is to negotiate a contract type and price (or estimated cost and fee) that will result in reasonable contractor risk and provide the contractor with the greatest incentive for efficient and economical performance.

ACHIEVING A REASONABLY CHALLENGING BUT ACHIEVABLE (RCA) TARGET COST

This approach starts with the premise that the Government's objective negotiation position represents a reasonably challenging, but achievable target cost. In this context, achievable means attainable with management focus on efficient and economical performance. In return, the contractor has the opportunity to achieve rewards, through operation of higher profit rates and attractive share ratios, commensurate with the risk assumed. These reasonably higher profit rates and favorable share ratios represent the most favorable profitability profile DoD will offer during negotiations. The Government strategy is to reward the contractor for controlling cost. This should be the most favorable profitability offer from the Government made in negotiations.

. . . .

However, if in order to settle, we have to go to a higher cost than the data justifies, that is a concession which results in a reduced profit and less favorable share ratios for the contractor. In general, think about it in these terms: as cost goes down, profit goes up; as cost goes up, profit goes down.

BUDGET IMPLICATIONS

(Budget to Most Likely Price)

Contract Type	Budget To
FFP	Negotiated Price
FP-EPA	Negotiated Price (do not budget for EPA)
FPIF	Target Cost + Target Profit
CPFF	Estimated Cost + Fixed Fee
CPAF	Estimated Cost + Base Fee + Maximum Award Fee
CPIF	Target Cost + Target Fee

FAR 7.105 CONTENTS OF WRITTEN ACQUISITION PLANS

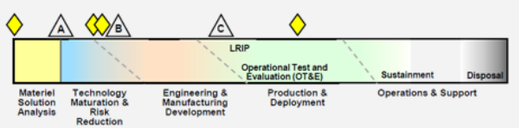
(b) *Plan of action* –

(3) *Contract type selection.* Discuss the rationale for the selection of contract type. For other than firm-fixed-price contracts, see 16.103(d) for additional documentation guidance. Acquisition personnel shall document the acquisition plan with findings that detail the particular facts and circumstances, (*e.g.*, complexity of the requirements, uncertain duration of the work, contractor's technical capability and financial responsibility, or adequacy of the contractor's accounting system), and associated reasoning essential to support the contract type selection. The contracting officer shall ensure that requirements and technical personnel provide the necessary documentation to support the contract type selection.

"TYPICAL" CONTRACT TYPES BY PHASE

NOTE: Section 818 (NDAA for FY 07), Contract Type Selection On Development Efforts, eliminated the limitation on fixed-price development contracts. Section 811 (NDAA for FY 13), Limitation On Use Of Cost-type Contracts, eliminated their use on production contracts.

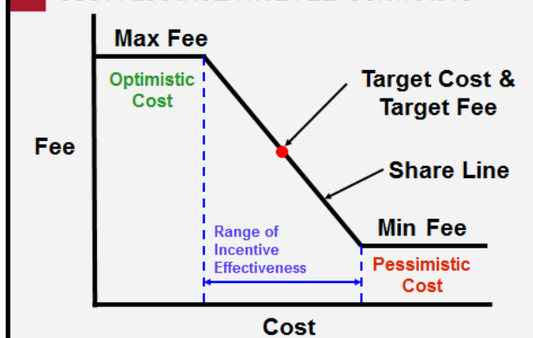
Model 1: Hardware Intensive Program



CPFF | FPIS FPIF CPFF CPIF CPAF | FPIS FPIF FP(EPA) FFP

For MDAPs, authorization for cost reimbursement contract for EMD requires an MDA written determination, and for Production a USD(AT&L) written certification to congressional defense committees.

COST-PLUS-INCENTIVE-FEE CONTRACTS



ACQUISITION STRATEGY AND ACQUISITION PLAN

DoD Instruction 5000.02, "Operation of the Defense Acquisition System," January 7, 2015

- PROGRAM MANAGEMENT RESPONSIBILITIES
  - Acquisition Strategies
    - Business Approach and Risk Management

Defense Acquisition Guidebook

- Program Strategies
- Program Management Activities

Federal Acquisition Regulation

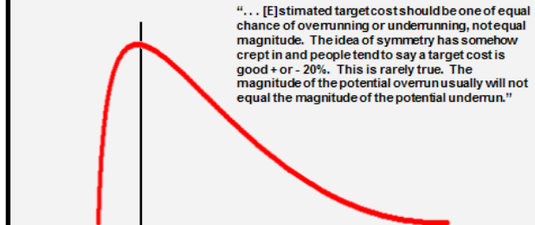
- COR Designation
- Acquisition Plan
- Contract Type

FAR POLICIES ON CONTRACT TYPE

- **The cost-plus-a-percentage-of-cost system of contracting shall not be used.**
- **Commercial contracts under FAR Part 12 shall be firm-fixed-price contracts or fixed-price contracts with economic price adjustment. A time-and-materials contract or labor-hour contract may be used for the acquisition of commercial services under limited conditions.**
- **Sealed bid contracts under FAR Part 14 shall be firm-fixed-price contracts or fixed-price contracts with economic price adjustment.**
- **Contracts negotiated under FAR Part 15 may be of any contract type or combination of types.**

DISTRIBUTION OF COST OUTCOMES

Does Not Follow a Bell Shaped Curve



"… [E]stimated target cost should be one of equal chance of overrunning or underrunning, not equal magnitude. The idea of symmetry has somehow crept in and people tend to say a target cost is good + or - 20%. This is rarely true. The magnitude of the potential overrun usually will not equal the magnitude of the potential underrun."

There is limited potential for underrun, but infinite potential for overrun.

BEST EFFORTS

A contractual obligation to *attempt* to meet a goal – as, for example, under the LIMITATION OF COST CLAUSE, which requires contractors to use best efforts to perform the work within the estimated cost of the contract.

The Government Contracts Reference Book, 4th Ed.

The most complete definition of the term we have found is contained in In re Cambridge Biotech Corp., 186 F.3d 1356, 1375 (Fed. Cir. 1999), where the Court of Appeals for the Federal Circuit quoted approvingly a state court decision which explains that "'best efforts' requires 'that the party put its muscles to work to perform with full energy and fairness the relevant express promises and reasonable implications therefrom.'"

Northrop Grumman Computing Systems, Inc., Appellant, v. General Services Administration (GSBCA 16367)

ACQUISITION STRATEGY

DoDI 5000.02, ENCLOSURE 2 PROGRAM MANAGEMENT

6. PROGRAM MANAGEMENT RESPONSIBILITIES.
   a. Acquisition Strategies

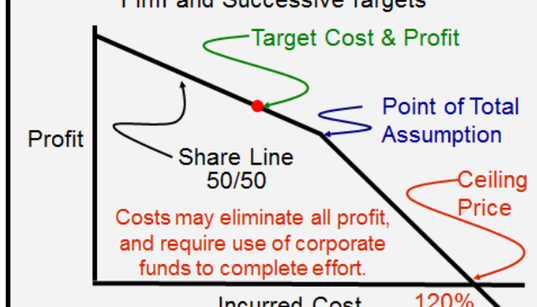
(2) Business Approach and Risk Management. The business approach detailed in the Acquisition Strategy should be designed to manage the risks associated with the product being acquired. It should fairly allocate risk between industry and the government. The approach will be based on a thorough understanding of the risks associated with the product being acquired and the steps that should be taken to reduce and manage that risk. The business approach should be based on market analysis that considers market capabilities and limitations. The contract type and incentive structure should be tailored to the program and designed to motivate industry to perform in a manner that rewards achievement of the government's goals. The incentives in any contract strategy should be significant enough to clearly promote desired contractor behavior and outcomes the government values, while also being realistically attainable.

FAR 16.104 FACTORS IN SELECTING CONTRACT TYPES

- **Price competition.**
- **Price analysis.**
- **Cost analysis.**
- **Type and complexity of the requirement.**
- **Combining contract types.**
- **Urgency of the requirement.**
- **Period of performance or length of production run.**
- **Contractor's technical capability and financial responsibility.**
- **Adequacy of the contractor's accounting system.**
- **Concurrent contracts.**
- **Extent and nature of proposed subcontracting.**
- **Acquisition history.**

FIXED-PRICE-INCENTIVE CONTRACTS

Firm and Successive Targets



GUIDANCE ON CONTRACT TYPES & INCENTIVES

Guidance On Using Incentive And Other Contract Types, April 2016
https://acc.dau.mil/CommunityBrowser.aspx?id=739473&lang=en-US

Contract Pricing Reference Guides
https://acc.dau.mil/CommunityBrowser.aspx?id=406579

Contract Cost, Price & Finance CoP
https://acc.dau.mil/CommunityBrowser.aspx?id=134461

Incentive Strategies for Defense Acquisitions, January 2001
http://www.acq.osd.mil/dpap/Docs/incentives010501.pdf

DOD and NASA Guide: Incentive Contracting Guide, 1969
https://acc.dau.mil/CommunityBrowser.aspx?id=189615